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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

Texas Office of Public Utility Counsel's
Reply Comments

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EXECUTIVE SUMMARY

Throughout this debate on how to introduce competition for telecommunications services, the local exchange carriers (LECs) and the interexchange carriers (IXCs) have been able to come to agreement on one item: raise rates for people who are least able to afford price increases and raise rates for customers who have no or few competitive alternatives. In a suprising show of unity, the largest LECs and the largest IXCs ask this Commission to raise the subscriber line charge (SLC).

Additionally, these companies propose to implement Ramsey pricing principles to raise rates for those customers who are viewed as "less desirable". The LECs request "make whole" provisions to protect themselves from any competitive pressures, while IXCs argue for decreases in the prices they pay for access without any guarantee of verifiable price reductions for all consumers.

Telecommunications service is a necessity. Precisely because this service is a necessity, it demonstrates the price and income elasticities of all necessities. As income falls, expenditures for this commodity rise as a percentage of income. Poorer households are forced to spend a higher percentage of their incomes to maintain their well-being. Ramsey pricing of necessities in the transition to competition is bad economic and bad social policy.

Claims by the industry that consumers will see a net benefit from access price reductions because of lower long distance rates are not substantiated by economic analysis. Using Sprint's own data, poorer households will see a ***net increase*** of $.50 for every dollar increase in the SLC. An increase in the SLC with a decrease in long distance rates would negatively effect all income groups, except for the most wealthy. Although extremely high users in any group would save, the vast majority of consumers would be worse off.

We agree that the SLC is an impermissible subsidy; it allows IXCs to cost-shift their portion of local loop costs onto customers. Congress clearly understood the impetus for LECs and IXCs to attempt to shift loop costs onto customers and explicitly forbade this practice. The Commission should assess the IXCs their portion of loop costs. Correct assessment of loop costs and recognition of lower access charges should result in the elimination or substantial lowering of the SLC.

I. INTRODUCTION

The Texas Office of Public Utility Counsel (Texas OPC), has filed comments in each of the major proceedings initiated by the Commission since the passage of the Telecommunications Act of 1996. We have urged the Commission to pursue a vigorous, pro-competitive path under the new law, one which introduces competition in both the local and long distance industries in a fair and rapid fashion.

The Comments in this proceeding demonstrate that the vast majority of telecommunications companies (local and long distance) overwhelmingly have one and only one goal in mind for access charge reform --- to keep their revenue stream whole. The primary vehicle for doing so would be to shift costs from the companies onto the end user by raising the subscriber line charge. The net effect would be to increase the price of basic monthly service and increase the telephone bills of the majority of residential ratepayers.

Such an outcome is contrary to the intention of the Telecommunications Act of 1996 and could only be accomplished if the Commission ignores the clear consumer protection provisions of section 254(k) of the Act. Virtually all non-industry commentors urge the Commission to either at least not raise the SLC or to lower it dramatically.

Texas OPC urges the Commission to reject the specious arguments of the industry interests. The subscriber line charge should be eliminated and all prices moved quickly to the level of efficient, forward looking costs. Texas OPC has joined in the reply comments of several other major national consumer groups which deal primarily with the economic principles of efficient pricing in the transition to competition.[1] These comments focus on the faulty logic

[1] Texas OPC has joined the Reply Comments of the Consumer Federation of America, the American Association of Retired Persons, and Consumers Union with regard to those issues.

underlying and the inequitable burden that would result from the proposals to raise the price of basic monthly service to protect the profit streams of the incumbent LECs and long distance companies.

II. INDUSTRY PROPOSALS

The comments of Southwestern Bell Telephone Company,[2] Sprint, and AT&T -- which represent two of the largest local companies serving Texas residential ratepayers and two of the largest long distance companies serving the state -- are particularly troubling. They suggest an immediate and substantial increase in basic service rates, in the range of at least $2 to $3 per month, through an increase in the subscriber line charge. Additionally, much larger local rate increases are proposed in the near future through rate rebalancing.

SBC, at present a local exchange company, proposes to simultaneously increase the subscriber line charge on residential customers, lower it on large business customers, and impose a flat rate make-whole surcharge on long distance companies. It proposes a variety of pseudo "public policy elements" which would have the effect of insulating it from virtually all competitive pressures on its revenue stream.

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[2] Unless otherwise noted, references to individual companies and commentors are to Comments filed in Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, and Usage of Public Switched Network by Information Service and Internet Access Providers, CC Docket Nos. 96-262, 94-1, 91-213, 96-263, January 29, 1997.

Sprint[3] and AT&T[4] propose to increase the end-user charge and sharply reduce charges paid by long distance companies to local companies, without proposing any form of mandated verifiable price reductions for long distance customers.[5] The net effect would be to immediately increase their profits and allow them to selectively lower prices to protect their market position.

All three parties have offered a series of economic and legal arguments to support their proposals to increase basic service rates. Sprint, in particular has attempted to present empirical

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[3] Although Sprint is frequently viewed as a moderate in public policy matters because of its unique nature as both a local and a long distance company, in this case it must be seen as radical. The tensions that exists between monopolist and potential new entrant which cause Sprint to act moderately in most "competitive" proceedings, simply do not exist in this context where self interest can be promoted at the expense of ratepayers. To simultaneously protect its local and long distance businesses, it proposes to shift all costs to the end user. Under Sprint's proposal, the rates of captive customers go up, while the profits of local companies are protected and the profits of long distance companies increase. Sprint gets to charge local customers more and take the difference in increased profits in its long distance business. Sprint argues that long distance competition will force its long distance arm to pass any cost reductions through, but the lock-step rate increases that the industry has practiced make it clear that rate reductions will come slowly at best, and for residential ratepayers who will bear the burden of local rate increases, they will come last and least.

[4] AT&T's Chief Executive Officer recently pledged to ensure local and long distance rates at levels no higher than currently available, but AT&T has offered no regulatory mechanisms to ensure a pass through of any cost reductions it receives. Having just raised basic rates by several times the rate of inflation, such public pledges should be viewed as little more than *ex parte* public relations gimmicks.

[5] Texas OPC proposed a mechanism in its initial comments to ensure that customers receive actual benefit from any access charge reductions. We continue to believe that our proposal is the fairest, adminstratively easiest, and most effective means of passing these cost savings on to consumers.

evidence on several key points. These arguments are based on a combination of errors of commission and omission to which Texas OPC responds in these reply comments:

1) Their economic arguments lack a real world basis;

2) They misdefine the word "affordable";

3) They fail to present any substantiation for their claims of benefits to consumers (they present no incidence analysis); and

4) They blatantly and consciously misdefine the word "subsidy" by misrepresenting the relationship between revenues and costs.

III. RAMSEY PRICING OF NECESSITIES IN PARTIALLY COMPETITIVE MARKETS

Through economic analysis, Sprint has discovered that telephone service is a necessity. That is, it has a low elasticity of demand. Sprint observes that because telecommunications is a necessity, its price can be raised and people will continue to pay for it, with minimal effect on subscribership.

> Although the intent to make local service “affordable” may have been laudable, it also may have been misguided as a matter of economics. Basic access to the network -- local service -- is almost perfectly price-inelastic -- i.e., consumers will not drop off the network to any significant degree in the face of a price increase. (Sprint, p. 5).

Sprint discovers that not only is basic service a necessity, but also long distance service because it too has a relatively low price elasticity. Even poor people use these services -- just as poor people buy food to eat, use electricity to for lighting, air-conditioning and refrigeration, and natural gas for cooking and heating.

> Nonetheless, it is interesting to note that even very low income households spend almost as much as on these various other services as households with far greater income. (Sprint, p. 6).

Based on the observation that these services are necessities, Sprint proposes to rebalance rates, to charge whatever the market will bear.

> The clear implication of these data is that rate rebalancing should not be considered a dirty word. Consumers -- even very low income consumers -- value their communications services, and their spending patterns on toll service and optional features suggest that they can afford a price for their connection to the network that is substantially closer to costs than the prices they are paying today. (Sprint, p. 6).

The substantial increases in basic service that Sprint proposes at the federal level would be followed by additional rate increases at the state level. Sprint goes so far as to suggest that the federal government impose rate increases if the states will not.

> These steps will immediately reduce the interstate access charges currently paid by IXCs by roughly one-half, will place only a modest additional (but economically justified) burden on end users -- a burden that in many cases will be offset largely or completely by lower toll charges -- and will give the ILECs a brief period of time to adjust to a new legal and competitive environment and to manage their remaining above-cost charges down to a forward-looking cost-based level.
>
> These steps will also pave the way for similar reforms by the states. However, if the states do not follow the Commission's lead, the Commission must be prepared to act, pursuant to sections 253 and 254, to override the state policies that result in continued implicit subsidies and undue barriers to entry. (Sprint, p. 8).

Sprint proposes a safety net program to address the most dire impact of local rate increases for these necessities.

> Obviously, consumers who simply cannot afford to pay the costs of their connection to the network either because of their low income or because they live in high cost areas, must be taken care of. Sprint expects the Commission's universal service plan will provide a safety net for such persons (Sprint, p. 6).

Sprint defends its pricing proposal on the basis of the theoretical preferability of Ramsey Pricing.

> If price mark-ups are needed, economic efficiency is maximized if the mark-up is inversely proportional to the elasticities of demand for the several services involved (Sprint, Exhibit 2, p. 3).

Texas OPC has demonstrated in previous comments that Ramsey pricing of necessities in the transition to competition is bad economic policy and bad social policy. Texas OPC has previously demonstrated why the inverse elasticity rule is inappropriate for telecommunications in general and the pricing of an intermediate good, such as access, in particular.

> In no event should the Commission adopt Ramsey pricing as a cost allocation scheme. Ramsey pricing has positive welfare properties only under a very stringent set of assumptions. [footnote deleted]. Most importantly, the products in case should be final products and *not* intermediate goods. Because interconnection services and network elements are intermediate goods, Ramsey pricing may well have negative welfare effects. Indeed, given the critical importance of interconnection services and network elements in the competitive strife between new and incumbent LECs, it is likely that a Ramsey pricing (cost allocation) scheme would weight the balance in favor of the incumbent LECs, thus hampering rather than futhering the development of local exchange competition. Surely, the Commission could -- and should -- adopt a more competitively neutral method for allocating joint and common costs, *if any is needed at all.*[6]

[6] Texas OPC Initial Comments, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, May 16, 1996, (pg. 27).

At the same time that Texas OPC was vociferously advocating for fair pricing policies for competitors, our office also recognized the need for fair pricing principles to protect end-users from cost shifting.

> Indeed, one of OPC's overriding concerns in regard to the Act of 1996, and the developments it may spur in telecommunications markets, is that the incumbent LECs will seek to recover any lost revenues -- or even forgone revenues they might have earned in the absence of competitive entry -- from captive ratepayers. In view of this, OPC urges the Commission to adopt and maintain policies that would prevent cost shifting by incumbent LECs, or activities of incumbent LECs to recover lost revenues from ratepayers that, for all practical purposes, do not yet, and may not for a long time, have access to alternative providers.[7]

It harms the credibility of competitors' arguments when they argue against Ramsey pricing for themselves, but argue in favor of Ramsey pricing for end-users. Obviously, the rationale for rejecting the use of Ramsey pricing is the same for both IXCs and consumers.

Ironically but not suprisingly, one of the Regional Bell Holding Companies (RHCs) has also advocated against Ramsey pricing when its use would harm its status as a potential new entrant in foreign markets. U S West International made the following observations when it argued that Ramsey pricing of necessities in partially competitive industries should be rejected:

> However, there are two policy problems to this approach:
>
> > By setting the highest price for the most inelastic customers, the heaviest burden is being placed on those who depend upon the product most. This may have undesirable social policy consequences.

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[7] Texas OPC Initial Comments, Local Competition at pg. 16.

> More importantly, it is impossible to segment classes of customers in a partly competitive market. Demand naturally becomes more elastic when there are competing alternatives. The Ramsey rule would suggest shifting prices from areas which are competitive to areas which are still monopoly provided - an anti-competitive move which allows the operator to cross-subsidize competitive markets from un-competitive markets. Customers object, as do other operators who, typically, have no monopoly of their own to exploit.

Furthermore, in a partly competitive market, the incumbent no longer faces the demand curve with its set of elasticities. It must instead take elasticities from its own demand curve which will differ from that of the markets as a whole, thus creating a different set of cross-subsidized prices from the social-optimal set derived by Ramsey pricing in a monopoly.[8] (U S West International, A Framework for Effective Competition, A Response to OFTEL's Consultative Document From U S West International, February 6, 1996, pp. 29-30.

We agree with US West International's observations. The Commission should ensure that its pricing policies are both economically sound and equitable in their applications to all groups. Ramsey pricing is both anti-competitive and anti-consumer. The Commission should reject Ramsey pricing of access.

IV. AFFORDABILITY

Although Sprint cites efficiency grounds (incorrectly) as the basis for its Ramsey pricing proposal, it devotes more attention to the social implications of its proposal. Sprint suggests that

[8] Us West International, A Framework for Effective Competition, A Response to OFTEL's Consultative Document from US West International, February 6, 1996, pp.29-30.

low income households can afford price increases because they spend almost as much on telecommunications services as upper income households.

> For example, the average overall monthly expenditure on both local and long distance services for households with income under $10,000 annually is $45.40, which is 88% of the $51.90 spent by households with incomes in the $40-50,000 range. (Sprint p. 6).

Texas OPC believes that Sprint's conclusions about the impact of its pricing policy are wrong because, *inter alia*, it uses an incorrect definition of affordability. Texas OPC has addressed this incorrect definition of affordability at length in its Universal Service comments.[9]

Sprint's definition of affordability is absolute -- if you are willing to pay for it, it must be affordable, regardless of the impact. This not the primary definition in the dictionary. Affordability is not measured by the willingness of people to bear the pain of paying inflated prices for a necessity. The primary definition of affordability is a relative definition -- does the price paid cause serious detriment or inconvenience.

> Affordability:
>
> (1) (a) To manage to bear without serious detriment; (b) To manage to pay for or incur the cost of.[10]
>
> (1) (a) To manage to bear without serious detriment; (b) to be able to bear the cost of.[11]

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9 *See e.g.*, Texas OPC Initial Comments, In the Matter of Federal-State Joint Board on Universal Service, (April 12, 1996); Texas OPC Reply Comments, Universal Service at pp. 13-21 (May 7, 1996).

10 Webster's Third New International Dictionary, Philip Babcock Grove (Ed.), 1986, p. 36.

11 Merriam-Webster's Collegiate Dictionary, Tenth Edition, 1995, p. 20.

> (1) To be able to undergo, manage, or the like without serious consequence; (2) to be able to meet the expense of or spare the price of.[12]

We know that people can be forced to pay excessive amounts for necessities, such as telecommunications. The Commission should be cognizant that telecommunications is a necessity and analyze the burden that the price paid for necessities places on consumers household budgets. Sprint's own data can be used to demonstrate the burden problem.

Figure 1 shows the percent of income that is devoted to telephone service in Sprint's data base. For each income category, the median is used to estimate the percentage. Among households with incomes below $10,000 telephone service takes approximately 10 percent of income. For households with incomes in the $40-50,000 range, the monthly bill takes less than 2 percent of income. Sprint's proposed increase of the SLC by $3.33 would result in an additional one percent of income spent. **Under Sprint's regressive proposal, low income households will spend a larger percentage of their income to pay for the increase in the SLC, alone, than households with incomes above $75,000 will pay for their entire telephone bill, including the increase in the SLC.**

V. CONSUMER BURDENS AND BENEFITS

Sprint offers assurances that price increases for basic service will be offset by price reductions elsewhere, caused by market forces.

> Thus, the typical consumer will see substantial reductions in charges for toll calls and optional service features, that may largely offset -- or even more than offset -- any increase in basic monthly local rates that may occur. (Sprint, p. 7).

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[12] Random House Webster's College Dictionary, 1995, p. 24.

However, Sprint's use of qualifiers such as increases "may" be offset, or that the burdens of increases in "many"[13] cases will be offset by price reductions is critical. Sprint offers no guarantee of any rate reductions. At most, it argues that competition will lower rates for services with higher elasticities of demand.

In its Universal Service comments Texas OPC challenged these claims.

> The claim that the long distance market is sufficiently competitive to compel price decreases is arguable at best.
>
> Sprint acknowledges that the local market is not currently sufficiently competitive to be relied upon to impose pricing discipline.
>
> Even for long distance services, the elasticities of demand it cites are by no means high. In fact, the overwhelming majority of non-basic revenues come from services with elasticities of demand that are inelastic (less than one) and therefore not subject to significant downward pressure on pricing.

Sprint's own evidence can be used to demonstrate that typical residential ratepayers will not benefit from other price reductions and will, in fact, fare worse off. Sprint's economic analysis demonstrates that telecommunications service is what is known in economics as an inferior good. As income rises, people spend a smaller percentage of their income on that good. Basic necessities have this property.

> Inferior Good: (1) A good which is demanded less as consumers' incomes rise. (2) A good with an **income elasticity of demand** less than one. Some foodstuffs, e.g., potatoes, rice, and margarine are in this category.[14]

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[13] *See e.g.*, Sprint's quote on page 5 of these comments.

[14] Donald Rutherford, Routeledge Dictionary of Economics (Routeledge, 1992), p. 224.

In fact, the price and income elasticities of telecommunications services are typical of necessities. Price increases for necessities impose welfare losses on those least able to afford telephone service.

Because telephone service is a necessity, it becomes more and more difficult to reduce consumption as income declines. That is, poorer households will try to spend less for this commodity at lower levels of income, but they find it more and more difficult to do so because it is a necessity. As a result, at each lower level of income, expenditures for this commodity rise as a percentage of income, although they fall in absolute value. Households are forced to spend a larger share of their income on telephone service to maintain their well-being. Figure 1 which incorporates Sprint's data demonstrates this point.[15]

More formal econometric analysis of elasticities verifies that telecommunications service is a necessity. We have already observed that demand elasticities are low. Analysis indicates that income elasticities -- the response of demand for telephone service to changes in income -- are generally positive but less than one and larger than the price effects. Thus, telecommunications service exhibits the price and income elasticities expected from a necessity.

Because the price elasticity is low, consumers have difficulty substituting for this commodity when its price increases. Yet, because the income elasticity is high relative to the price elasticity, it indicates a large decrease in utility with a price increase.

> When substitution effects are large relative to income effects, consumers can substitute away from goods whose prices have risen with little loss in utility. However, when income effects are large relative to substitution effects, an increase in price means a relatively large decrease in utility. Since the income

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[15] OPC provided equivalent data for the nation in Table 5, Reply Comments, Universal Service at pg. 19.

> effect is indicated to be large relative to the substitution effect in the price elasticity of demand for access for households with low income, particularly if they are young, the welfare of these households may be significantly decreased by an increase in the price for basic service.[16]

Only if the offset of basic and long distance price changes are equal would residential ratepayers not be harmed. In fact, this is not likely to happen.

Raising basic monthly rates falls most heavily on low volume users, while price reductions are to the benefit of high volume users (see Figures 2 and 3). If Sprint passes through the rate reductions in proportion to usage, the burden on low volume users outweighs the benefit many times. The most likely losers will be residential consumers and small businesses which make no long distance calls. Almost 3 percent of residential consumers have no long distance bill (intraLATA or interLATA) in the Sprint data. Over 14 percent of businesses have no long distance bill. For all ratepayers taken together, a pass through of cost reductions in proportion to usage imposes a burden that is larger than the benefit up to 2000 minutes of use. This applies to 90 percent of all ratepayers and 90 percent of residential ratepayers.

To the extent that prices are reduced for residential customers, the reductions are more likely to go to upper income households than low and middle income households (see Figure 4). Even if price reductions were passed through evenly, households with incomes above $50,000 would receive approximately 50 percent more than households with incomes below $20,000 and 30 percent more than households with incomes between $20,000 and $50,000.

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[16] Lester Taylor, Telecommunications Demand: A Survey and Critique (Cambridge Massachusetts: MIT press, 1980), p. 82.

The previous two analyses can be combined to estimate the incidence of Sprint's proposed $3.33 increase in the SLC on residential ratepayers at various income levels. Assuming a proportionate pass through, approximately 30 percent of the reduction in costs goes to multi-line businesses.[17] The remainder is spread among the income groups in proportion to their consumption of long distance services.

Figure 5 shows that in the aggregate, all groups are worse off, except the highest income group. Very high users in any income group would save, but the vast majority of consumers would be worse off, particularly lower income consumers. In our Universal Service comments, using less detailed data, we estimated that for every one dollar increase in basic rates, low income consumers would end up with net bill increases of $.25.[18] Using Sprint's more detailed data, we must revise that estimate upward. For households with incomes below $10,000 for every dollar increase in the SLC, they are likely to have a net increase in their bill of $.50. Up through the middle class, every dollar increase in the SLC is likely to result in net bill increases of $.33. This is truly a case of trickle up economics.

Moreover, given the distribution of revenues, Sprint is unlikely to pass through any cost reductions equally to all customer groups. Sprint is more likely to target its price cuts to its high volume customers. Contrary to Sprint's claims, basic long distance rates have not been tracking access charges. Since 1990, access charges have declined by 15 percent, but interLATA long

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[17] Sprint's data shows that 56 percent of business customers generate only 3 percent of business CCL revenues. We assume that these are single line businesses.

[18] Texas OPC Reply Comments, Universal Service at pg. 23.

distance rates are up by 15 percent. The targeting of discounts has resulted in increases in basic long distance rates in the past several years.

Sprint's promises that "many" customers "may" see rate reductions in long distance equal to their rate increases for basic service should give little solace to the majority of residential ratepayers. Given the inelasticity of demand, the opportunity for Ramsey pricing, and the industry's past practices toward low volume consumers, net price increases are inevitable.

For this reason, Texas OPC restates its recommendation that any cost reductions afforded to long distance companies be passed through in a mandatory form that ensures reductions for residential ratepayers. In our initial comments we recommended that the SLC be eliminated. While this is not a guarantee that their net bill will go down (long distance companies could raise per minute charges, as they have done in the past), it would likely hold low use customers harmless against net increases in their bills. If the SLC is not eliminated, then the competitive pressures of the marketplace will not act in the manner Congress intended.

VI. SUBSIDY ISSUES

Sprint and SWB attempt to persuade the Commission that an increase in the SLC is justified to avert an impermissible subsidy. However, this analysis is faulty because it uses an apples to oranges comparison. Sprint compares the *marginal* cost of long distance (and other services) to the *total* cost of local service. Using this misstatement of economics, Sprint argues that the subscriber line charge must be raised to eliminate a subsidy. In fact, the exact opposite is the case. The CCL cannot be eliminated or it would result in a subsidy.

In the executive summary, Sprint describes the current rate structure as follows:

> And to the extent that today's above-cost access charges have been used to help local rates below a cost-based level, the present structure harms CLECs as well: as long as they must compete with ILECs that charge below-cost rates for local service, the CLECs can profitably serve only those customers that generate substantially above-average toll usage. (p. ii).

In the text below, note that Sprint places the adjective "full" in front of local costs, but not in front of any of the other costs to which it refers.

> ILECs were expected to use other sources of revenue -- above-cost interstate and intrastate access charges, revenues from above-cost intraLATA toll charges, and above-cost charges for optional service features (such as call waiting, call forwarding and caller ID) and local business services -- in order to keep residential rates at an artificially low level. (p. 4).

> Current state policies have resulted in rates -- particularly for smaller ILECs whose costs may be higher than those of the RBOCs -- that are manifestly low. For example, the Sprint LECs' overall average monthly rate for residential services is $11.85. In New Jersey, it is only $7.80. No one can seriously contend that these rates cover the ***full*** cost of local service (emphasis added). (pp. 4-5).

This argument is simply wrong. The *full* cost of local service must include the cost of a loop, because a call cannot be completed without a loop. The *full* cost of long distance service also includes the cost of a loop as well, because a long distance call cannot be completed without it. The loop is a common cost shared between local and long distance. The FCC has recognized this fundamental fact in both the Interconnection Order and in the Access Charge Notice.

Congress understood the tendency of the industry to shift costs to their most captive customers. It explicitly forbade this practice. In Section 254 (k) Congress banned cross-subsidies. Furthermore, it stipulated that basic service would bear at most a reasonable share of joint and common costs.

Sprint's entire analysis is incorrect and should be rejected because it rests on a faulty assumption. Once one recognizes that the loop is a common cost, the elimination of the CCL, as proposed by Sprint is economically and legally incorrect.

Southwestern Bell bases its argument on a similar misconception. It argues that IXC payment for use of the loop is an implicit subsidy and proposes to eliminate such payments by increasing the subscriber line charge.

> Carrier Common Line ("CCL") charges represent an implicit support flow for access to local exchange service...
>
> SWBT requests that ILECs be granted the flexibility to eliminate any interstate CCL that remains after it has been adjusted for the effect of NUSF, LTS, payphone, marketing expense, and reallocations to reduce the transport interconnection charge ("TIC"). SWBT proposes initially to recover these remaining interstate common line costs using a flat-rated public policy element billed to the IXCs on a presubscribed line basis. SWBT proposes to eliminate this public policy element charge over a two year period by incrementally increasing the SLC for residence and single-line business lines. SWBT anticipates nominal SLC increases of approximately \$.65 at the end of year one and \$.65 at the end of the second year.

Southwestern Bell proposes to further allow the IXC use of the line side switch ports without paying for them.

> Local switching prices currently recover the cost of a port that is dedicated to end-users. The port represents a non-traffic sensitive ("NTS") cost associated with connecting the end-user's line to the switch matrix. SWBT proposes to recover port costs with a monthly flat rate end-user charge and reduce local switching prices commensurately. (p. 8).

The loop and the port are obviously common costs for which all services that utilize them must pay. Eliminating the IXC's contribution to these common costs results in illegal cost-shifting onto customers.

VII. THE TAKINGS CLAIM

Southwestern Bell spends the bulk of its testimony repeating claims that local exchange companies must be guaranteed recovery of all of their embedded costs. It proposes an elaborate scheme of flat rate charges imposed on end-users and interexchange carriers to ensure this full recovery (see Table 1).

TABLE 1

Southwestern Bell's Cost Shifting Proposal
(Monthly Flat Rate Per Line Charges)

	End-user	IXC
CCL	1.30	.80
	.35	
Separations		.80
Transport		.88
Depreciation		.55
Total	1.65	3.03

Texas OPC has demonstrated in this proceeding and others why these claims for guaranteed cost recovery should be rejected by the Commission. We need not restate the arguments here. Economic theory and existing case law contradict these claims and the Commission has acted and must continue to act on that basis.[19]

Although Southwestern Bell has simply reiterated its previously rejected arguments that it is entitled to protection from the impact of competition, it has provided two new citations to proceedings in the states. Southwestern Bell claims these cases demonstrate the "prudence" and, therefore, the recoverability of all of its costs. Leaving aside the fact that case law clearly shows that prudence is not sufficient grounds for guaranteed cost recovery, Texas OPC notes that neither of these cases is from Texas and certainly does not purport to include investments made nationally by all carriers. Moreover, the cases are extremely dated, suggesting that the "prudence" of these expenditures and investments has not been reviewed in quite some time. Certainly in the federal jurisdiction, the Commission has noticed the build up of excess capacity and excessive functionality in the network and repeatedly alerted the LECs to the fact that it would look into these matters. Just because the LECs disagree with the Commission as to the extent of excess capacity, does not means there is none.

It is ironic that after a decade in which profits soared, while local exchange companies vigorously avoided rate cases and aggressively sought abolition of rate of return regulation, they now want to invoke regulatory oversight as a justification of indemnification against the impact

[19] Texas OPC supported the Commission's use of TELRIC pricing for interconnection. Just as the Commission rejected SWB's specious takings argument with respect to its Interconnection Order, it should continue to reject these claims with respect to access charge reform.

of competition. Numerous commentors have pointed out that price cap regulation has already given LECs the flexibility and incentive to bear the risk of their own actions and the vast majority of assets the LECs claim to be at risk were placed after the onset of price cap regulation in the federal jurisdiction. There never was an obligation to make LECs whole in the federal jurisdiction and any such pretense should have been dropped by the LECs with the introduction of price cap regulation.

VIII. CONCLUSION

Texas OPC supports the Commission's attempt to reform access charges. The use of forward-looking, efficient costs should be the basis for pricing access. The SLC should be eliminated to ensure that consumers receive the benefit of the reduction in these prices. Make-whole provisions which attempt to protect the revenue streams of incumbents and which result in cross-subsidies should be rejected. Leadership by the Commission on these issues will ensure that the competitive market envisioned by Congress in the passage of the Act is accomplished.

Dated: February 14, 1997

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Figures 1-5

FIGURE 1
PERCENT OF INCOME SPENT FOR TELEPHONE SERVICE